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No. 91-1513

IN THE

Supreme Court of the United States

October Term, 1991

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

vs.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondents.

Petition For a Writ of Certiorari To the United States Court of Appeals For the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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STATUTORY PROVISIONS INVOLVED

In addition to the statutes cited by the Petitioners, the following provisions of Ohio's Insurers Supervision, Rehabilitation and Liquidation Act, Chapter 3903, Revised Code, are important to a consideration of the question presented by the Petitioners.

Section 3903.02(D), Revised Code:

(D) The purpose of sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through all of the following:

(1) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures;

(2) Improved methods for rehabilitating insurers, involving the cooperation and management expertise of the insurance industry;

(3) Enhanced efficiency and economy of liquidation, through clarification of the law, to minimize legal uncertainty and litigation;

(4) Equitable apportionment of any unavoidable loss;

(5) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extending the scope of personal jurisdiction over debtors of the insurer outside this state;

(6) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business.

Section 3903.42, Revised Code:

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any

payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(a) Class 1. The costs and expenses of administration, including but not limited to the following:

(1) The actual and necessary costs of preserving or recovering the assets of the insurer;

(2) Compensation for all services rendered in the liquidation;

(3) Any necessary filing fees;

(4) The fees and mileage payable to witnesses;

(5) Reasonable attorney's fees;

(6) The reasonable expenses of a guaranty association, or foreign guaranty association in handling claims.

(B) Class 2. Debts due to employees for services performed to the extent that they do not exceed one thousand dollars and represent payment for services performed within one year before the filing of the complaint for liquidation. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority that may be authorized by law as to wages or compensation of employees.

(C) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to order destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other

benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium or other premium refunds.

(D) Class 4. Claims of general creditors.

(E) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under division (H) of this section.

(F) Class 6. Claims filed late or any other claims other than claims under divisions (G) and (H) of this section.

(G) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in according with law.

(H) Class 8. The claims of shareholders or other owners.

ARGUMENTS FOR DENYING THE PETITION

Respondent agrees that the decision of the court of appeals squarely conflicts with decisions of the two other courts of appeals that have decided the issue. *See Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988). Respondent also agrees that the question presented is an important one, although not for the reason articulated by the Petitioners. The important question is not the effect upon federal revenue.[1] Rather, the question is the preservation of the congressional purpose underlying the McCarran-Ferguson Act, 15 U.S.C. 1012, to "broadly give support to the existing and future state systems for regulating and taxing the business of insurance." *Prudential Insurance Company v. Benjamin*, 328 U.S. 408, 429 (1946).

1. The court of appeals correctly concluded that Section 3903.42, Revised Code, is exempt from federal preemption as a regulation of the "business of insurance" within the McCarran-Ferguson Act. The court of appeals' conclusion does not conflict with precedents of this Court.

Petitioners' argument on this point is simply that the liquidation of an insolvent insurance company pursuant to the provisions of state insurance insolvency statutes does not neatly fall within the three criteria set out in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982):

[1] The claims of the federal government filed with the Liquidator of the American Druggists' Insurance Company arise from bonds issued by ADIC as surety not from tax claims owed by ADIC to the United States Treasury.

> First, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.

458 U.S. at 129.

However, the Petitioner's argument that the court of appeals misapplied and misconstrued all three prongs of the *Pireno* test simply ignores the appellate court's analysis.

a. With regard to the first prong of the *Pireno* test, the Petitioners argue that the "Ohio priority statute does not have the effect of tranferring and spreading a policyholder's risk." Petition at 8. Petitioners' erroneous conclusion results from their tortured interpretation that only events surrounding the actual issuance of the insurance policy could satisfy *Pireno* and that the transfer of risk is complete at the time the insurance policy is issued. Such a narrow interpretation evidences a benighted appreciation for the realities of the true business of insurance. Moreover, Petitioners' contentions are a poor analysis of the first prong of the test and flatly ignore the specific language of *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969). In *National Securities,* Justice Marshall enumerated several examples of activities which constitute the "business of insurance" including fixing of rates, selling and advertising of policies and the licensing of companies and their agents. 393 U.S. at 460. The Court further stated:

> The relationship between insurer and insured, the type of policy which could be issued, *its reliability, interpretation, and enforcement—these were the core of the "business of insurance."* Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. *Statutes aimed at protecting* or regulating *this relationship, directly or indirectly, are laws regulating the "business of insurance."* (emphasis added).

393 U.S. at 460.

Indeed, the Court in *National Securities* evidenced a broad interpretation to the term "business of insurance":

> The applicable statute requires the state director of insurance to find that the proposed merger would not "substantially reduce the security of and service to be rendered to policyholders" before he gives his approval (citation omitted). This section of the statute clearly relates to the "business of insurance."

393 U.S. at 462.

Accordingly, contrary to the assertions of Petitioners, *National Securities* broadly interpreted the language and intent of McCarran-Ferguson to apply to statutes aimed, directly or indirectly, at securing the interests of those purchasing insurance policies, and assuring the reliability of those policies.

To appreciate the fatal error of the Petitioners' analysts, one need only apply their interpretation to the examples set forth by Justice Marshall in *National Securities.* The fixing of rates, the adjusting of policies and the licensing of insurance companies and their agents could not satisfy the Petitioners' narrow interpretation of the first prong of the *Pireno* test. Yet, state statutes regulating these activities would clearly constitute the regulation of the "business of insurance" within McCarran-Ferguson.

The purely sterile environment of Petitioners' theoretical argument about risk spreading seems to only account for the precise instant in time when the insured and insurer enter the contract. However, risk spreading without insuring the reliability of the insurer who has insured the risk is of no value to the insured and does not carry out the specific intent of the insurance contract. Section 3903.42, Revised Code supports the entire contractual risk transfer process between insurer and insured by providing some assurance that the transfer of the risk to the insurer will be accomplished in the event of the insurer's insolvency. The court of appeals correctly concluded that the first prong of the *Pireno* test was satisfied.

b. Section 3903.42, Revised Code, effects the essence of the central contractual relationship between the insurer and the insured by reinforcing the relationship and underscoring the enforcement of that contractual relationship when the insurer is financially impaired. Section 3903.42, Revised Code is designed to strengthen the contractual relationship by prioritizing the claims of policyholders and thereby enhancing the reliability of the contractual relationship. The liquidation statutes, and specifically Section 3903.42, Revised Code, go directly to the heart of reliability and enforceability of the insurance policies as they provide mechanisms for adjustment of claims, the defense of insureds, the interpretation of policies and the payment of proper claims. To reach another conclusion would not comport with the realities of the "business of insurance."

Petitioners argue that Section 3903.42, Revised Code, is not integral to the contractual relationship between the insurance company and the insured as it is "obviously distinct from the contract of insurance itself." (Petition at 10). Any state statute regulating the

business of insurance is distinct from the contract of insurance. Section 3903.42, Revised Code, is integral to the relationship between the insolvent insurer and its policyholders as it protects the claims of policyholders arising from their contractual relationship with the insolvent insurer. In fact, the insurer/insured relationship is in sharper focus in liquidation proceedings than in everyday insurance business. There are no stockholders to satisfy, no bottom line profit to be reached. The single goal of insurance liquidation is to maximize the potential recovery of those who have relied on the insurer over the years—the policyholders. The Petitioners' attempt to argue to the contrary simply ignores the true facts of the liquidation process. Section 3903.42, Revised Code, also satisfies the second prong of the *Pireno* test.

c. The Petitioners argue that the third prong of the *Pireno* test is not satisfied, as that the liquidation process is not limited to entities within the insurance industry. The flaw in this argument is the simple fact that the liquidation statutes can only be applied to insolvent insurance companies. Chapter 3903, Revised Code, is, by definition, limited in application to *only* those entities within the insurance industry. Section 3903.03, Revised Code. The fact that "other" claimants are listed in the priority statute simply takes into account the realities of the business and the fact that other claims may exist. The focus, however, is on the insurer/insured, entities clearly within the insurance industry. When the liquidation statute is viewed in total, the third prong of the *Pireno* test is also clearly satisfied.

2. The decision of the court of appeals is not inconsistent with the purpose and legislative history of the McCarran-Ferguson Act. Indeed the appellate court correctly acknowledged the purpose of the Act: "Congress passed the McCarran-Ferguson Act, 15 U.S.C.

§1012, to protect the domain of the state over the 'existing and future . . . systems for regulating and taxing the business of insurance.' *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429 (1946)." (Decision, 4a of Appendix to Petition). The court of appeals also correctly dispensed with Petitioners' argument that *United States v. Knott*, 298 U.S. 544 (1936) is dispositive of this matter:

> First, McCarran-Ferguson did not return to the status quo prior to South-Eastern Underwriters; instead, it only permitted state regulation of the "business of insurance," without federal interference. Royal Drug, 440 U.S. at 220 n. 24. Second, even if it had, the Florida statute at issue in Knott contained only generalized provisions protecting domestic creditors in Florida insurance companies over foreign creditors; it in no way regulated the "business of insurance" for the protection of the insured.

Decision, 13a-14a, Appendix to Petition.

Moreover, Petitioners ignore the plain language of 15 U.S.C. 1012(B) that:

> "*No* Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any state for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance. (Emphasis added).

Thus, *all* federal statutes that do not relate specifically to insurance are subordinated to state law, except those (*e.g.*, the Sherman Act, etc.) specifically mentioned in the remaining portion of paragraph (B) not quoted above. By failing to expressly preserve the supremacy of the federal claims priority statute, that supremacy was lost. The court of appeals' analysis of the purpose and legislative history of the McCarran-Ferguson Act was correct and its decision was totally consistent with both the purpose and legislative history of the Act.

CONCLUSION

While the decision of the court of appeals conflicts with decisions of the two other circuits which have ruled on the important question presented in this case, the decision is correct and the petition for a writ of certiorari should be denied.

Respectfully submitted,

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